# SML Isuzu Limited Revised

November 29, 2018

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Cash Credit | 25.00 | 18.00 | [ICRA]AA(Stable); Reaffirmed |
| Short-term Fund-Based Limits | 125.00 | 137.00 | [ICRA]A1+; Reaffirmed |
| Short-term Non-fund based limits | 35.00 | 30.00 | [ICRA]A1+; Reaffirmed |
| Commercial Paper | 50.00 | 50.00 | [ICRA]A1+; Reaffirmed |
| **Total** | **235.00** | **235.00** | |

*Instrument details are provided in Annexure-1

## Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) and short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 185.00-crore bank facilities of SML Isuzu Limited. ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 50.00-crore[1] to the commercial paper programme of SML Isuzu Limited (SML or the company) [2]. The outlook on the long-term rating is Stable.

## Rationale

The rating reaffirmation takes into consideration SML's strong market position in the school and executive bus segment in India, strong parentage from Sumitomo Corporation (43.96% as on September 30, 2018) and healthy, albeit slightly weakening, financial profile. Although SML's credit metrics have come under pressure in the last few quarters because of pressure on its profit margins combined with higher debt levels, ICRA expects it to return to the earlier levels in the near-term supported by strong volume growth and operational efficiencies from the recent plant upgradation.

The ratings take into consideration the company's strong presence in the school and executive bus segment in India supported by its strong brand and expanding sales channel. Unlike the domestic commercial vehicle (CV) industry, majority of SML's sales is generated from the bus segment (56% in FY2018), with school buses accounting for approximately 80% of its total bus sales. The company's bus sales witnessed a strong growth of 43% in H1 FY2019 on a YoY to 4,655 buses. The strong growth was primarily supported by healthy demand for buses and low-base effect. The company's bus sales had declined by 23.0% in FY2018 because of certain one-off factors such as pre-buying in March 2017 (Q4 FY2017) and deferment of demand with expectations of price rationalization following implementation of Goods and Services Tax (GST). In addition, the company's production was also affected by shortage of critical components.

The company's business profile continues to be constrained by its limited presence in the goods carrier segment (trucks). SML's product portfolio is restricted to the light commercial vehicles (LCV) and intermediate commercial vehicles (ICV) segment in the range of 3.5-ton to 12-ton, which accounts for only 11-12% of the total CV sales in India. Within this segment, SML lost market share in FY2018 (5% in FY2018, down from 9% in FY2017) because of production related issues and competition from other OEMs.

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

However, the company is undertaking initiatives to improve its market share in this category by expanding its distribution presence along with its re-branding and addition of new dealers, investment to modify cabin designs that would enhance marketability and help upgrade its product portfolio.

In CY2012, Isuzu Motors Limited had acquired a 15% stake in SML and this was expected to expand SML's product portfolio, especially in the HCV segment. Although Isuzu's presence in the company was expected to translate into greater technical support, the progress on new model launches (on Isuzu's platforms) has been relatively behind schedule and has not helped SML in expanding its addressable market. At present, Isuzu's technical assistance has been limited to new cabin design for the Global Series trucks.

SML's credit metrics in the last 4-6 quarters have deteriorated as compared to earlier levels as reflected by decline in coverage indicators such as interest coverage ratio and total debt to OPBDIT ratio. The weakness in the company's credit metrics was due to declining profitability combined with significant increase in debt levels. In FY2018, the operating profit margins declined to 3.9% from 8.0% in FY2018 because of decline in unit sales and lower absorption of fixed overheads. Although the strong growth in unit sales in H1 FY2019 (30%) was expected to significantly improve the profit margins, the pressure on profit margins continued because of sharp rise in commodity prices and limiting pricing power of the company. The decline in profit margins combined with higher debt levels (to fund plant expansion and vehicle modernisation) led to contraction in the coverage indicators. ICRA expects the company's credit indicators to return to earlier levels in the near-term supported by steady growth in unit sales and better operational efficiencies due to the recent upgradation in the plant infrastructure.

## Outlook: Stable

ICRA believes SML's credit metrics will return to the earlier levels on back of improvement in profitability due to steady sales growth and increase in operational efficiencies. The outlook may be revised to Negative if the credit metrics of the company do not improve in the near-term. The outlook maybe revised to Positive if the company is able to gain significant market share on a sustained basis, especially in the goods carrier segment.

## Key rating drivers

## Credit strengths

**Strong market position in the school bus and executive coach segment in India** - SML has a strong presence in the school bus and executive coach segment in India with a market share of 15-18%. The company's strong presence in this segment is supported by its strong brand and expanding sales channel. School bus sales account for 80% of SML's total bus sales.

**Plugging portfolio gaps and expanding sales network to support growth** - The company is taking steps to improve its product portfolio, especially in the trucks segment. The company has launched 'Global Series Trucks' earlier this year with new improved cabin having features for more comfort and safety, and it is equipped with telematics solution. The telematics solution is expected to reduce the cost of operations for the fleet owners and make SML's trucks more attractive.

**Strong parentage by virtue of being majority owned by Sumitomo Corporation (rated Baa1 by Moody's)** - The Sumitomo Corporation is the major shareholder of the company (44% stake as on September 30, 2018) and it lends both managerial as well as strategic support to the company. The promoters have active representation in the company's board and senior management and the Managing Director is from Sumitomo Corporation.

**Comfortable financial profile although there has been some weakness in credit metrics in FY2018 because of lower sales and debt-funded capital expenditure** - The SML has a comfortable financial profile supported by low leverage and strong liquidity profile. However, there has been some weakness in the credit metrics n the last 4-6 quarters because of decline in profit margins and increase in debt levels.

## Credit challenges

**Marginal player in the domestic CV industry because of limited product range as compared to large CV OEMs -** The company is a marginal player in the domestic CV industry because of limited presence in the 3.5-ton to 12-ton segment. It is not present in other segments such as heavy trucks, pick-ups and mini-trucks. This limits the company's market share in the domestic CV industry.

**Limited capabilities to effectively compete with incumbents in goods carrier segments, especially HCV segment** - The SML has limited capabilities to compete with incumbents in the goods carrier segments, especially in the HCV segment. Although, the investment from Isuzu was supposed to greater technical collaboration between SML and Isuzu Motors, the progress on new model launches (on Isuzu's platforms) has been relatively behind schedule.

**Competitive intensity in the bus segment is also increasing with foray of new players** - The competition in the bus segment is also increasing with the foray of new players into SML's addressable segments.

**Exposed to cyclicality in the CV industry; although higher share of buses partially mitigates the risk** - The SML is exposed the cyclicality in the CV industry and it leads to volatility in its cash flows and profit margins. However, it is partially mitigated by higher share of buses in its portfolio which has comparatively steadier demand.

## Liquidity Position:

The company's liquidity profile is supported by cash balances (Rs 34.3 crore as on September 30, 2018), unutilized working capital lines (Rs. 144.2 crore as on September 30, 2018) and improvement in cash generation. However, the company will have sizeable debt repayment in the near term which will be met using the company's internal accruals.

## Analytical approach:

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology<br>Rating Methodology for Commercial Vehicle Industry |
| Parent Support | Parent Company: Sumitomo Corporation, Japan<br>The rating of SML Isuzu assumes an implicit support from Sumitomo Corporation, as it owns majority stake (43.96%) in the company and provides managerial and strategic support. The managing director and four other board members of SML Isuzu are representative of Sumitomo Corporation. |
| Consolidation/ Standalone | The rating for SML Isuzu Limited is based on the standalone financials. |

## About the company:

Incorporated in 1983, SML Isuzu Limited (SML Isuzu, formerly Swaraj Mazda Limited) was initially set up as 'Swaraj Vehicles Limited' for the manufacture of Light Commercial Vehicles (LCVs). In 1984, the company was promoted by Punjab Tractors Limited (PTL) in technical and financial collaboration with Mazda Motor Corporation, Japan, and Sumitomo Corporation, Japan.

The technical collaboration agreement with Mazda expired in 2004 and Mazda exited by selling off its stake to Sumitomo Corporation. Around the same time, SML entered into a technical collaboration agreement with Isuzu Motors, Japan. SML Isuzu operates in the Light Commercial Vehicle (LCV) and Medium Commercial vehicle (MCV) segments of the automobile industry. The company has a manufacturing facility at Nawanshahar Punjab, with a capacity to manufacture 24,000 units per annum. SML Isuzu has a product portfolio of buses, trucks (including tippers) and specific application vehicles.

## Key financial indicators (audited)

| | FY2017 | FY2018 |
|---|---|---|
| Operating Income (Rs. crore) | 1,354.6 | 1,132.9 |
| PAT (Rs. crore) | 63.0 | 8.5 |
| OPBDIT/OI (%) | 8.0% | 3.9% |
| RoCE (%) | 25.8% | 3.5% |
| | | |
| Total Debt/TNW (times) | 0.1 | 0.5 |
| Total Debt/OPBDIT (times) | 0.4 | 4.8 |
| Interest coverage (times) | 17.6 | 4.1 |

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years:

| | | Current Rating (FY2019) | | | | Chronology of Rating History for the Past 3 Years | | |
|---|---|---|---|---|---|---|---|---|
| | Instrument | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore) | Date & Rating<br>Nov 2018 | Date & Rating in FY2018<br>Aug 2017 | Date & Rating in FY2017<br>Oct 2016 | Date & Rating in FY2016<br>June 2015 |
| 1 | Cash Credit | Long Term | 18.00 | NA | [ICRA]AA (Stable) | [ICRA]AA (Stable) | [ICRA]AA (Stable) | [ICRA]AA- (Stable) |
| 2 | Short-term Fund-Based Limits | Short Term | 137.00 | NA | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ |
| 3 | Short-term Non-fund based limits | Short Term | 30.00 | NA | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ |
| 4 | Commercial Paper | Short Term | 50.00 | NA | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ |

## Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

## Annexure-1: Instrument Details

| ISIN No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Cash Credit | NA | NA | NA | 18.00 | [ICRA]AA (Stable) |
| NA | Short-term Fund-Based Limits | NA | NA | NA | 137.00 | [ICRA]A1+ |
| NA | Short-term Non-fund based limits | NA | NA | NA | 30.00 | [ICRA]A1+ |
| NA | Commercial Paper | NA | NA | 7-365 days | 50.00 | [ICRA]A1+ |

Source: SML Isuzu Limited

## Annexure-2: Corrigendum

Document dated November 29, 2018 has been corrected with revisions as detailed below:

- Rationale, page 1: Last line of second paragraph has been revised
- Liquidity Position, page 3: Unutilized working capital lines as on September 30, 2018 revised to Rs. 144.3 crore
- Analytical Approach, page 3: In the ‘Parent Support’ section the number of board members of SML Isuzu who are representative of Sumitomo Corporation has been revised to four.

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## About ICRA Limited:

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